Report

of the

Examination of

Network Health Insurance Corporation

Menasha, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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November 21, 2003

Honorable Jorge Gomez
Commissioner of Insurance
Madison, Wisconsin

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

NETWORK HEALTH INSURANCE CORPORATION
MENASHA, WISCONSIN

and this report is respectfully submitted.

I. INTRODUCTION

This is the first examination of Network Health Insurance Corporation, as the company commenced business on August 1, 2001. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

Network Health Insurance Corporation (NHIC) is a for-profit stock insurance company organized under ch. 611, Wis. Stat. The major product line for the insurer is a Point of Service (POS) health insurance plan.

NHIC was incorporated on March 1, 2001, and commenced business on August 1, 2001, as an indemnity insurer. NHIC is a wholly owned subsidiary of Network Health Plan (NHP) and provides indemnity-type (POS) health insurance to its members.

NHP is owned by Network Health System, Inc (NHS). Effective September 1, 1998, Affinity Health System (AHS) acquired the common and preferred stock of NHS. AHS is co-sponsored by Wheaton Franciscan Services, Inc., and Ministry Health Care, Inc.

According to its business plan, NHIC's service area is comprised of the following counties: Brown, Calumet, Dodge, Fond du Lac, Green Lake, Manitowoc, Marquette, Outagamie, Portage, Shawano, Sheboygan, Waupaca, Waushara, and Winnebago. The principal service area of the company is the Fox Valley region.

NHIC has no individually contracted providers. Payments to providers are handled under fee-for-service arrangements. However, NHIC contracts with a national preferred provider organization (PPO) and receives discounts from providers under the PPO agreement.

NHIC has separate agreements with Kimberly Clark and Alliance Laundry Service in which premiums are adjusted on a retrospective basis to total medical costs incurred during the year. NHIC also receives an administrative fee from the employer groups.

NHIC offers comprehensive health care coverage, which may be changed by riders to include deductibles and co-payments. The following is a list of basic health care coverages provided:

Physician services
Inpatient hospital services
Outpatient hospital services
Mental health, drug, and alcohol abuse services
Ambulance services
Prosthetic devices and durable medical equipment
Newborn services
Home health care
Family planning
Hearing exams and hearing aids

Diabetes treatment
Routine eye examinations
Convalescent nursing home service
Prescription drugs with co-payments
Cardiac rehabilitation, physical, speech, and/or occupational therapy
Kidney disease treatment
Certain transplants
Chiropractic services

Inpatient mental health and AODA coverage in NHIC policies is limited to 10 days per calendar year. Outpatient mental health and AODA coverage is limited to 20 visits per calendar year and transitional treatment is limited to 20 visits per calendar year. Emergency services have between $25.00 and $100.00 co-payment requirement, which is waived upon admission to an inpatient facility. Skilled nursing care is limited to 60 days. The company also has various coinsurance plans in which services have a 70/30, 80/20 or 90/10 coinsurance split, subject to an annual maximum in the range of $1,000 to $9,000/single and two to three times the single amount per family contract.

Certain preventative services are not covered. Out-of-NHP network maternity, skilled nursing facility, extended care facility, and inpatient and some outpatient hospital services require precertification. Reimbursement for these services will be reduced 50% up to a maximum reduction of $500 per occurrence as a penalty for failing to precertify.

Currently, NHIC markets to employer groups, and association members. NHIC utilizes employee account representatives, as well as outside brokers.

NHIC uses an actuarially determined base as a beginning point in premium determination. For small groups, as defined in the Wisconsin Statutes, this rate is adjusted to reflect the age, sex, coverage characteristics, and risk assessment of the new groups. Experience is reviewed for renewal groups, and based on the review; adjustments are made to a group's risk assessment factor, within limits as dictated by law. For large groups, this rate is adjusted to reflect the age, sex and coverage characteristics. Experience is reviewed for groups and a recommendation is made regarding adjusting the rates or canceling the groups given a credibility factor that is actuarially determined based on group size. Rates are determined by an experience adjustment to base rate, with a credibility factor. The base rate is adjusted quarterly for inflation and other trending factors.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of five members. Directors are elected annually to serve a three-year term. Officers are appointed by the board of directors. Members of the company's board of directors may also be members of other boards of directors in the Affinity System. The board members currently do not receive compensation for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Sheila Jenkins Neenah, WI	Network Health Plan President	2003
Scott Nygaard, MD Hortonville, WI	Affinity Medical Group Chief Medical Officer	2003
Jeff Badger Appleton, WI	Affinity Health System Vice President – Finance	2004
David Romond, MD Oshkosh, WI	Affinity Medical Group Medical Director & Orthopedics	2003
John Bubolz Appleton, WI	Greystone Capitol Group, L.L.C. Managing Director	2004

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	2002 Salary
Sheila A. Jenkins	President	$5,668*
Jeff S. Badger	Secretary	444*
Scott D. Nygaard, M.D.	Treasurer	564*

*These are employees of Affinity Health System and are paid by AHS based on a corporate allocation.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. There were no active committees at the time of the examination.

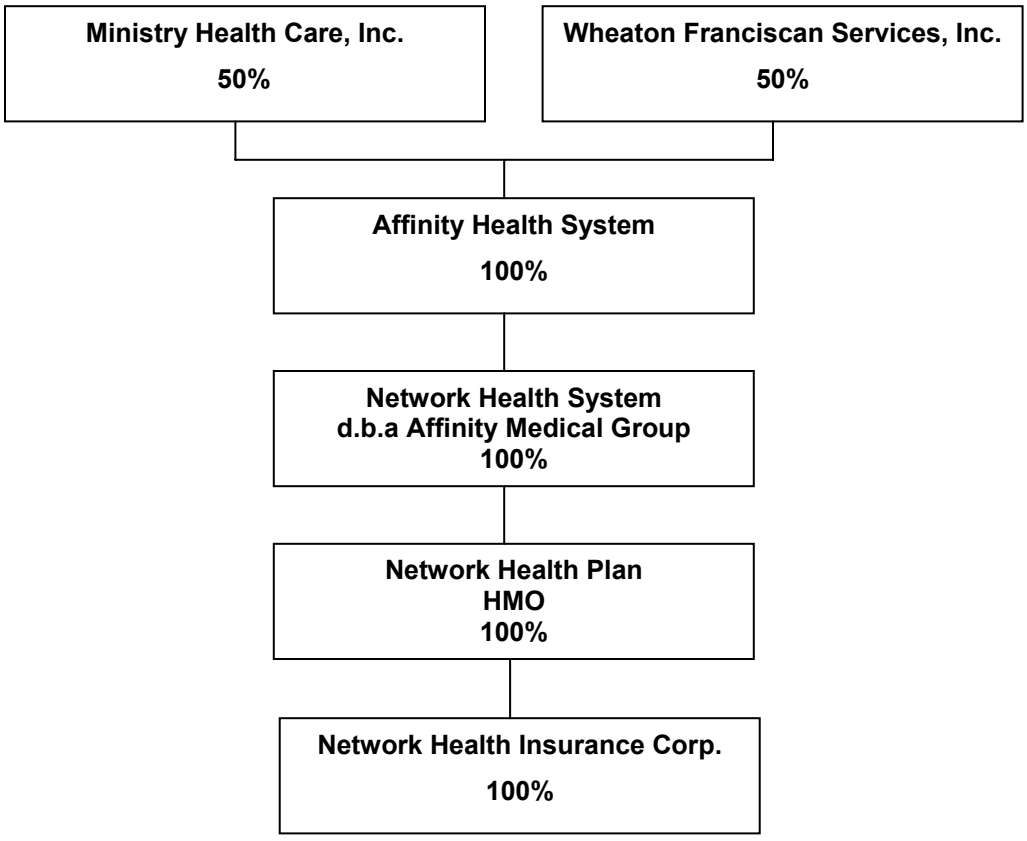
Operations

The company has no employees. Necessary staff is provided through administrative services and program agreement with Network Health Plan. Under the agreement, effective July 1, 2001, NHP agrees to market the POS contracts; provide general administration support for the indemnity coverage and underwriting services; complete group application and enrollment forms; and provide for billing of premiums, utilization review, claims processing, and member services, including member grievances, inquiries, and complaints. NHP receives 13% of POS premiums, adjusted for refunds, commissions, government charges or assessments, and claims paid for the quarter net of subrogation, as compensation for services rendered. The term of the agreement is one year. The company may terminate the agreement by providing written notice of termination on or before September 30 of that year. If either party commits a material breach of its obligation and the breaching party fails to remedy the breach within 14 days, the other party may terminate the agreement by written notice specifying a date of termination not less seven days thereafter.

IV. AFFILIATED COMPANIES

Network Health Insurance Corporation is a wholly owned subsidiary of Network Health Plan (NHP) and NHP is a wholly owned subsidiary of Network Health System (NHS). NHS, a multispecialty clinic is a wholly owned subsidiary of Affinity Health System, which is co-sponsored by Ministry Health Care, Inc., and Wheaton Franciscan Services, Inc. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of the company follows the organizational chart.

Holding Company Chart
As of December 31, 2002



Ministry Health Care, Inc.

Ministry Health Care, Inc., is a Wisconsin nonstock, not-for-profit corporation that manages, promotes and supports the health care and related ministries of the Milwaukee region of the Sisters of the Sorrowful Mother. As of September 30, 2002, the company's audited financial statement reported assets of $1.18 billion, liabilities of $662.0 million, and capital and surplus of $518.2 million. Operations for 2002 produced net income of $16.6 million on revenues of $731.1 million.

Wheaton Franciscan Services, Inc.

Wheaton Franciscan Services, Inc. (WFS), is organized as an Illinois not-for-profit organization and operates under the tenets of the Roman Catholic Church and in accordance with the philosophy and values of the Franciscan Sisters. WFS's subsidiaries provide general health care services to residents within its geographic locations including inpatient, outpatient, emergency room, physician, long-term care, and other related services. As of June 30, 2002, the company's audited financial statement reported assets of $1.56 billion, liabilities of $746.2 million, and capital and surplus of $818.2 million. Operations for 2002 produced net income of $90.8 million on revenues of $1.36 billion.

Affinity Health System

Affinity Health System (AHS) is an Illinois nonstock, not-for-profit corporation, whose corporate members are Ministry Health Care, Inc. (MHS), and Wheaton Franciscan Services, Inc. MHC and WFS operate an integrated health care delivery system in the Fox Valley of Wisconsin through Affinity Health System. MHC and WFS established common management of Affinity and the Affinity organization. As of September 30, 2002, AHS and affiliates combined financial statements reported assets of $368.2 million, liabilities of $187.8 million, and capital and surplus of $180.4 million. Operations for 2002 produced net income of $4.1 million on revenues of $425.6 million.

Network Health System

Network Health System (NHS) provides medical services through its clinic operations and managed care products and services through the company. NHS became a member of AHS

as a result of a series of transactions effective September 1, 1998. As of September 20, 2002, the company reported assets of $65.6 million, liabilities of $36.1 million, and capital and surplus of $29.6 million. Operations for 2002 produced net income of $49.1 million on revenues of $106.7 million.

Network Health Plan

Network Health Plan is a for-profit network health maintenance organization whose principal service area is the Fox Valley region in Wisconsin. The company offers comprehensive HMO coverages for groups, individuals, and Medicare-eligible persons. As of December 31, 2002, the company reported assets of $45.0 million, liabilities of $25.3 million, and capital and surplus of $19.7 million. Operations for 2002 produced net income of $5.3 million on revenues of $232.1 million.

V. REINSURANCE AND CORPORATE INSURANCE

The company has reinsurance coverage under the contract outlined below:

Reinsurer:	Employers Reinsurance Corporation
Type:	Specific Excess of Loss Reinsurance
Effective date:	January 1, 2003
Business Covered:	Commercial HMO, Commercial Point-of-Service
Services Covered:	Inpatient services, sub-acute and inpatient rehabilitation, skilled nursing, hospice, and home health care
Retention:	From $100,000 to $125,000 for hospital services.
Coverage:	Transplants: • Scheduled – 90% of charges in excess of the retention • Unscheduled – 90% of charges in excess of the retention that average $3,000 per day or less, 50% of charges that average over $3,000 Other Hospital Services: • 85% of charges in excess of the retention • Members referred to ParadigmHealth within 5 days of qualifying event – 95% of charges in excess of the retention
Lifetime Maximum:	$2,000,000 per member for inpatient services
Premium:	From $1.70 to $2.36 per member per month (pm/pm)

In addition, the company is provided with corporate insurance coverage under the contracts listed below:

Type of Coverage	Policy Limits
Directors' and officers' liability	$15,000,000
Fiduciary liability	15,000,000
Professional liability	3,000,000
Blanket crime	2,000,000

The above coverages were obtained through various insurance companies licensed in Wisconsin.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the HMO as reported in the December 31, 2002, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the HMO for the period under examination. Adjustments, if any, made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Net Worth per Examination."

Network Health Insurance Corporation
Assets
As of December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$1,771,333	$0	$1,771,333
Cash and short-term investments	2,263,494	0	2,263,494
Investment income due and accrued	25,488	0	25,488
Total assets	$4,060,315	$0	$4,060,315

Network Health Insurance Corporation
Liabilities and Net Worth
As of December 31, 2002

Claims unpaid		$ 525,083
Amounts due to parent, subsidiaries and affiliates		46,545
Total liabilities		571,628
Common capital stock	$3,000,000	
Unassigned funds (surplus)	488,687	
Total capital and surplus		3,488,687
Total liabilities, capital and surplus		$4,060,315

Network Health Insurance Corporation
Statement of Revenue and Expenses
For the Year 2002

Net premium income		$3,853,991
Medical and Hospital:		
Hospital/medical benefits	$2,569,074	
Other professional services	26,557	
Emergency room and out-of-area	6,079	
Prescription drugs	15,569	
Total medical and hospital	2,617,279	
Claims adjustment expenses	110,285	
General administrative expenses	349,627	
Total underwriting deductions		3,077,191
Net underwriting gain or (loss)		776,800
Net investment income earned		104,205
Net income or (loss) before federal income taxes		881,005
Federal and foreign income taxes incurred		326,500
Net income (loss)		$ 554,505

Network Health Insurance Corporation
Capital and Surplus Account
As of December 31, 2002

Capital and surplus prior reporting year	$2,934,181
Net income or (loss)	554,506
Capital and surplus end of reporting year	$3,488,687

Network Health Insurance Corporation
Statement of Cash Flows (Direct Method)
As of December 31, 2002

Cash from Operations	
Premiums and revenues collected net of reinsurance	$3,853,991
Claims and claims adjustment expenses	2,619,091
General administrative expenses paid	349,627
Cash from underwriting	885,273
Net investment income	105,776
Federal and foreign income taxes (paid) recovered	(326,500)
Net cash from operations	664,549
Cash from Investments	
Cost of investments acquired (long-term only):	
Bonds	(251,572)
Cash from Financing and Miscellaneous Sources	
Cash provided:	
Surplus notes, capital and surplus paid in	
Net transfers from affiliates	264,981
Net change in cash and short-term investments	677,958
Cash and short-term investments:	
Beginning of year	1,585,537
End of year	$2,263,495

Network Health Insurance Corporation
Compulsory and Security Surplus Calculation
December 31, 2002

Assets		$4,060,315	
Less liabilities		571,628	
Adjusted surplus			$3,488,687
Annual premium:			
Group life and health	$3,853,991		
Factor	10%		
Total		385,399	
Compulsory surplus (subject to a $2,000,000 minimum)			2,000,000
Compulsory surplus excess or (deficit)			$1,488,687
Adjusted surplus			$3,488,687
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million with a minimum of 110%)			2,800,000
Security surplus excess or (deficit)			$ 688,687

Growth of Network Health Insurance Corporation

Year	Assets	Liabilities	Capital and Surplus	Premium Earned	Medical Expenses Incurred	Net Income
2002	$4,060,315	$571,628	$3,488,687	$3,853,991	$2,617,278	$554,506
2001	3,350,792	416,612	2,934,180	1,330,177	1,474,209	(65,819)

Year	Profit Margin	Medical Expense Ratio	Administrative Expense Ratio	Change in Enrollment
2002	14.0%	67.9%	11.9%	(17.8)%
2001	-4.7	110.8	12.2	N/A

Enrollment and Utilization

Year	Enrollment	Average Length of Stay
2002	11,539	4.6
2001	14,030	2.3

Per Member Per Month Information

	2002	2001	Percentage Change
Premiums:			
Commercial	$27.47	$18.89	45.4%
Expenses:			
Hospital/medical benefits	$18.31	$15.67	16.8
Other professional services	0.19	5.22	(96.4)
Emergency room and out-of-area	0.04	0.03	40.5
Prescription drugs	0.11	0.01	1469.1
Less: Net reinsurance recoveries	0.00	2.47	(100.0)
Total medical and hospital	18.65	18.47	1.0
Claims adjustment expenses	0.79	0.00	100.0
General administrative expenses	2.49	2.30	8.2
Total underwriting deductions	$21.93	$20.77	5.6

Assets and liabilities increased 21.2% and 37.2% respectively from 2001 to 2002. As expected, the company's overall premium increased 189.7% from 2001 to 2002, being that premium was written and earned for a 12 months in 2002 versus five months in 2001. The Administrative Expense Ratio has remained consistent at 12% in both 2001 and 2002 while the Medical Expense Ratio decreased from 2001 to 2002 due to the increase in premium in 2002.

Reconciliation of Capital and Surplus per Examination

There were no adjustments or reclassifications to surplus as a result of this examination.

VII. SUMMARY OF EXAMINATION RESULTS

Management and Control

The examination's review of conflict of interest statements revealed the company does not have a formal policy in place for the signing of conflict of interest statements. For the year 2003, four of the five directors did not complete conflict of interest statements. It is recommended that the company require all members of the board of directors, corporate officers, and key employees complete conflict of interest statements annually, and retain such statements in the company's files.

Financial Reporting

The examination's review of the jurat page and board of director information revealed the company included an individual on the jurat page whose term expired on December 31, 2001. The person who replaced him was not included on the jurat page. In addition, the company reported in the general interrogatories there were 8,000 shares of common stock outstanding with a par value of $3,000 per share. The examiners determined that, according to the company's Articles of Incorporation and stock certificates, there are actually 1,000 shares of common stock outstanding with no par value. It is recommended that the company properly fill out the jurat page and the general interrogatories in accordance with the NAIC Annual Statement Instructions – Health, pursuant to s. Ins 50.20, Wis. Adm. Code.

Executive Compensation

The examination's review of form OCI 22-040, Report on Executive Compensation for 2002, noted that the form was not completed correctly. The company failed to comply with s. 611.63 (4), Wis. Stat., and did not list the salaries for all officers of the company. The company should have reported all direct and indirect compensation paid and accrued through the year. Insurers that are part of a group of insurers or a holding company may file amounts for the total group on a gross basis or by allocation to each insurer. It is recommended that the company properly complete Form OCI 22-040, Report on Executive Compensation, in accordance with s. 611.63 (4), Wis. Stat.

Cash on Hand

The examination revealed that if the company receives cash that is less than $1,000.00; it is not deposited that day, but kept in a locked cabinet. The key for the cabinet is not secured. While the amount of cash kept is immaterial, additional procedures should be in place to safeguard cash. It is recommended that the company establish procedures to adequately limit access to cash not deposited,.

Investments

The examiner's review of the board of director minutes noted that the board does not periodically approve the company's investments. According to s. 611.67(3), Wis. Stats., a company may delegate management authority to a person other than an officer, director or employee of the insurer if the person exercises the management authority according to the terms of the written contract between the insurer and the person, and if the contract is filed and not disapproved by this office. The custodian agreement, in effect at the time of this examination, was not a management agreement nor did it delegate investment review and approval authority. It is recommended that the company establish procedures to have investment transactions formally approved by the board of directors at least quarterly.

Management Agreements

Network Health Plan and Network Health Insurance Corporation filed taxes on a consolidated basis. The companies do not have a written tax agreement in place that was filed with OCI.. According to s. 617.21, Wis. Stat, a contract should be in place that clearly and accurately discloses the nature and details of the agreement. The agreement should also be fair and reasonable to the interest of the insurer and should be reported to the Office of the Commissioner of Insurance (OCI) under s. Ins 40.04, Wis. Adm. Code. It is recommended that the company enter into a tax allocation agreement with NHP and file the agreement and all future intercompany agreements with OCI pursuant to s. 617.21, Wis. Stat, and s. Ins 40.04, Wis Adm. Code.

Information Technology Security Violations

The examination revealed that the company does not proactively review security violations. The company contended that access level restrictions were assumed to prevent most security violations and system security reports to investigate potential violations. Monitoring security violations is an important control for identifying security breaches. It is recommended that the company implement a procedure to periodically review access security violations.

Information Technology Authorized Access

The examination revealed there is no formal policy to review whether all IDs are authorized, either at the network or application level. This is a concern since the company's local area network (LAN) is connected to a wide area network (WAN) where the WAN's network administrators have the ability to set up accounts on the company's LAN without the company knowing about it. In the last 18 months, the company has undertaken other projects that included a review of access. However; these were ad-hoc access reviews versus a formal procedure. It is recommended that the company implement a formal procedure to periodically review that all network and application IDs are authorized.

Disaster Recovery Plan

The current examination revealed that departmental disaster recovery plans have not been formally updated since 1997. The plans for the information technology (IT) department appeared to be current. However, it was indicated in the IT portion of the plan that a "hot site" had not been identified. The company indicated it was the responsibility of Affinity Health System, who contracts with an outside provider, to restore the network. The examiners requested documentation for the most recent test of its disaster recovery plan which was held in 2002. The company was able to provide documentation that appeared to be created as a result of the examiners' request. The company indicated that no other documentation was available. It is recommended that the company formally review, update, and test its disaster recovery plan on an annual basis and maintain adequate documentation on its plan.

VIII. CONCLUSION

Network Health Insurance Corporation (NHIC) is a for-profit stock indemnity health insurance company that commenced business on August 1, 2001, and whose major product line is a Point of Service (POS) plan. The principal area in which the company does business is the Fox Valley region of Wisconsin. NHIC is a wholly owned subsidiary of Network Health Plan. NHP is a wholly owned subsidiary of Network Health System. Network Health System is a wholly owned subsidiary of Affinity Health System which is co-sponsored by Wheaton Franciscan Services, Inc., and Ministry Health Care, Inc.

This was the first examination of NHIC since it commenced business in 2001. The reported assets increased from $3.4 million to $4.1 million and liabilities increased from $417 thousand to $572 thousand. These amounts represent increases of 21.2% and 37.2% respectively. The company's enrollment decreased 17.8% from 2001 to 2002. Overall premium has increased 189.7% from $1.3 million to $3.9 million. The company reported a net income in 2002 of $554,506 compared to a net loss of $65,819 in 2001.

As a result of the examination, there were no adjustments to surplus and the examination. Recommendations as a result of this examination are, listed on the following page.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 18 - Management and Control—It is recommended that the company require all members of the board of directors, corporate officers, and key employees complete conflict of interest statements annually, and retain such statements in the company's files.

2. Page 18 - Financial Reporting—It is recommended that the company properly fill out the jurat page and the general interrogatories in accordance with the NAIC Annual Statement Instructions – Health pursuant to s. Ins 50.20, Wis. Adm. Code.

3. Page 18 - Executive Compensation—It is recommended that the company properly complete Form OCI 22-040, Report on Executive Compensation, in accordance with s. 611.63 (4), Wis. Stat.

4. Page 19 - Cash on Hand—It is recommended that the company establish procedures to adequately limit access to cash not deposited.

5. Page 19 - Investments—It is recommended that the company establish procedures to have investment transactions formally approved by the board of directors at least quarterly.

6. Page 19 - Management Agreements—It is recommended that the company enter into a tax allocation agreement with NHP and file the agreement and all future intercompany agreements with OCI pursuant to s. 617.21, Wis. Stat, and s. Ins 40.04, Wis. Adm. Code.

7. Page 20 - Information Technology Security Violations—It is recommended that the company implement a procedure to periodically review access security violations.

8. Page 20 - Information Technology Authorized Access—It is recommended that the company implement a formal procedure to periodically review that all network and application IDs are authorized.

9. Page 20 - Disaster Recovery Plan—It is recommended that the company formally review, update and test its disaster recovery plan on an annual basis and maintain adequate documentation on its plan.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the HMO is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance (OCI), State of Wisconsin, participated in the examination:

Name	Title
Amy Wolff	Insurance Financial Examiner
Randy Milquet	Insurance Financial Examiner - Advanced

Respectfully submitted,

Sonja M. Dedrick
Examiner-in-Charge